Rural Debt Trap

This article is based on **What gives rise to the rural debt trap?** which was published in The Indian Express on 30/09/2021. It talks about the issues of rural debt trap and suggests a way forward.

The **All-India Debt and Investment Surveys (AIDIS),** carried out by the **National Statistical Office (NSO)** are among the most important nationally representative data sources on the rural credit market in India.

Recently published, the AIDIS report reveals that non-institutional sources have a strong presence in the rural credit market, notwithstanding the high costs involved in borrowing from them. Inadequate access to affordable credit lies at the heart of rural distress.

Findings of the AIDIS Report

- According to the report, the average debt per household in rural India is Rs 59,748, nearly half the average debt per household in urban India.
- A key indicator of access to credit is the **incidence of indebtedness (IOI)** — the proportion of households having outstanding loans.
- As per the latest AIDIS report, the IOI is 35% in rural India — 17.8% of rural households are indebted to institutional credit agencies, 10.2% to non-institutional agencies and 7% to both.
- The share of debt from institutional credit agencies in total outstanding debt in rural India is 66% as compared to 87% in urban India.

Reasons For Rural Debt Trap

- **Use of Credit For Household Purposes:** To know how socio-economic inequality shapes household indebtedness, the purpose of borrowing must be examined.
    - Institutional credit is taken mainly for **farm business and housing in rural India.**
    - A significant portion of debt from non-institutional sources is used for other household expenditures.
    - The data indicates that better-off households have greater access to formal-sector credit and use it for more income-generating purposes.
        - The top 10% rural households in terms of asset ownership spend almost two-thirds of their institutional debt and 40% of non-institutional debt on farm/non-farm business, whereas the bottom 10% spend half of their total debt on household expenditure.
- **Factor of Social Identities:** Access to credit is complicated by the interplay of social identities. The average asset ownership of Scheduled Caste and Scheduled Tribe households in rural areas is one-third as compared to upper-caste households.
- **Inadequate access to affordable credit** lies at the heart of the rural distress. Lack of marketable collateral, credit demand for consumption purposes and informational constraints have been the primary reasons for a large proportion of the rural population being excluded from institutional finance.
    - The credit policy needs to be revamped to accommodate the consumption needs of the rural poor and to find alternatives for collateral to bring the rural households within the network of institutional finance.
- **Rural Poors Lack Assets For Collateral:** Access to institutional credit is largely determined by the ability of households to furnish assets as collateral.
    - The report shows that the top 10% of asset-owning households have borrowed 80% of their total debt from institutional sources, whereas those in the bottom 50% borrowed around 53% of total debt from non-institutional sources.
- **Policy of Loan Waiver:** Loan waiver schemes disrupt credit discipline as farm loan waivers may act as a temporary solution and can prove to be a moral hazard in future.
    - This is because those farmers who can afford to pay their loans might not pay it expecting a waiver.

Way Forward

- **Measures to Improve the Reach of Institutional Credit:**
    - The Government of India should push state governments to complete the **digitisation process and updation of land records** in a time bound manner.
    - State governments should give access to banks to digitised land records in order to verify land titles and create charges online.
- **Increasing Credit Flow to Allied Activities:** Government should set separate targets for working capital and term loan towards allied activities.
- **Land Consolidation:** State governments should promote and conduct awareness drives for land consolidation so that the farmers can achieve economies of scale and have the incentive to make long term investments.

- **Agricultural Loans against Gold as Collateral:** Presently such loans are not separately flagged in **core banking solution (CBS)** platform of banks.
- **Farm Loan Waivers:** Government of India and state governments should undertake a holistic review of the agricultural policies and their implementation, as well as evaluate the effectiveness of current subsidy policies with regard to agri inputs and credit in a manner which will improve the overall viability of agriculture in a sustainable manner.
- **Credit Guarantee Scheme for Agriculture sector:** In India there is no guarantee scheme available to banks to cover the default risk of the borrowers.
    - Government in partnership with state governments should set up a credit guarantee fund for the agriculture sector on the lines of credit guarantee schemes implemented in the MSME sector.
- **Achieve Financial Inclusion:** Aggressive efforts are needed to improve institutional credit delivery through technology driven solutions to reduce the extent of financial exclusion of agricultural households.
    - Banks should explore collaborations with agri-tech companies/start-ups so as to provide access to credit in an integrated, timely and efficient manner to the farmers.

Drishti Mains Question

Rural debt trap is one of the main reasons at the heart of rural distress. Analyse.